United States Court of Appeals

for the Second Circuit

APPELLANT'S SUPPLEMENTAL BRIEF

76-7616

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P/S

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

IN RE
FRANKLIN NATIONAL BANK SECURITIES
LITIGATION

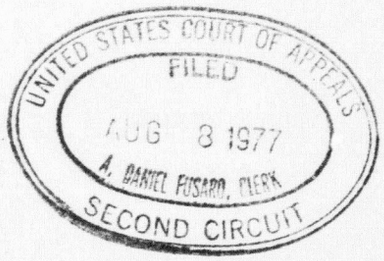
ROBERT GOLD, et al.,

Plaintiff-Appellant,

-against-

ERNST & ERNST, et al.,

Defendants-Appellees.



SUPPLEMENTAL BRIEF OF APPELLANTS

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PRELIMINARY STATEMENT

Pursuant to this Court's order dated July 8, 1977, appellants submit this Supplemental Brief with respect to the impact on the present appeal of this Court's recent en banc decision in Sanders v. Levy, No. 75-7608 (2nd Cir. June 22, 1977). Appellees have already filed a Supplemental Brief with respect to the impact of the Sanders en banc decision, and this brief of appellants both analyzes the relevance of Sanders and responds to the Supplemental Brief of appellees.

As shown below, the Sanders decision provides compelling grounds for reversing the decision below. Judge Platt's decision was predicated entirely on the panel's initial decision in Sanders, which decision has now been reversed en banc. Moreover, Sanders' holding that costs of identifying class members are discovery costs rather than notice costs confirms that the economic burden of such costs on the class representatives, and the relative burden of such costs if borne by the nominees, are properly considered in deciding whether the "reasonable effort" requirement of Rule 23 of the Federal Rules of Civil Procedure requires appellants to provide individual notice to security owners other than owners of record. If individual notice to beneficial owners of street name securities should be required, Sanders shows that the comparative economic burden on plaintiffs and nominees is relevant in deciding whether or not to make an exception to the general rule that a person responding to discovery must sustain his own costs.

ARGUMENT

THE SANDERS DECISION REQUIRES THIS COURT TO REVERSE THE DECISION BELOW

(a) The Sanders En Banc Decision

In its recent en banc decision, this Court held that the District Judge had not abused his discretion in requiring the Oppenheimer Fund, Inc. ("the Fund"), which was

a nominal defendant on derivative claims and a non-defendant on class claims, to shoulder the expense of extracting from its computerized records the list of the names and addresses of class members. In reaching this conclusion, this Court held that the decision of the Supreme Court in Eisen v. Carlisle & Jacquelin, 417 U.S. 156 (1974) (Eisen IV) did not require allocation to plaintiffs of the cost of identifying class members, because Federal Rule of Civil Procedure 34 provided a basis for requiring the Fund at its own expense to disclose in an intelligible form information contained in computerized records. Slip Opinion 4372.* This Court did not rest its decision solely on Rule 34, but strongly affirmed the principle that identification of the names and addresses of class members falls within the discovery provisions of the Federal Rules of Civil Procedure generally:

> "It hardly requires our extended discussion to establish that the information sought by plaintiffs as to the names and addresses of the class is indeed within the broad scope of permissible discovery established by our Federal Rules. Under Rule 26,'[p]arties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action....' Fed.R.Civ.P.26(b)(1). The holding of Eisen IV itself propels us ineluctably to the conclusion

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* References are to the Slip Opinion filed June 22, 1977.

> that the names and addresses of the class members are 'relevant to the subject matter' of a class action. By mandating that a representative plaintiff in a class suit send individualized notice to the members of his class, Eisen raises as a potential issue in all such litigation whether the required notice has properly been sent. A list of the names and addresses of the class members would of course be essential to the resolution of that issue. See Appleton Electric Co. v. Advance United Expressways, 494 F.2d 126, 138 (7th Cir.1971), cert. denied, 405 U.S. 921 (1972)." Slip Op. at 4373.

This Court recognized that under the discovery rules the District Court was entitled to shift the expense of special computer programming to the discovering party where the respondent would otherwise undergo "undue burden of expense", but held that the trial judge had not abused his discretion in refusing to shift the expense involved. Despite the fact that plaintiffs' demand created a need for special programming which required a $16,000 expenditure by the Fund, the Court stated that "we cannot say the burden thus imposed is unreasonable in light of the nature of the information sought and the extent and character of the fund's business operations." The $16,000 expense, while large "in absolute terms" was deemed not excessive in terms of the massive size of the fund and the extensive use of

computers in the Fund's business. Slip Opinion, p.4377. The Court mentioned as a second point that the allocation of costs to the Fund was not unreasonable in light of the fact that the defendants had rejected plaintiffs' proposed redefinition of the class which would have reduced such costs, Slip Opinion, pp. 4377-78.

(b) The Decision Below Was Wholly Determined by the Holding And Language in The Panel's Earlier Sanders Decision Which Has Now Been Rejected by This Court En Banc

Judge Platt deemed the issue at bar to be controlled by the decision of the Sanders panel that identification costs must be paid by plaintiffs, stating:

> "With respect to the first of the two issues raised by the parties, there are two recent decisions in this Circuit, the first of which indicates and the second of which holds that the 'plaintiff, and not the brokerage firms, must bear the cost of notifying class members.' Sanders v. Levy, et al., ___F.2d.___ (2d Cir., Slip Op.4577, June 30, 1976); Weiss v. Drew National Corporation, et al., ___F.Supp.___, at p.___ (S.D.N.Y. 75 Civ. 4816, July 15, 1976).
>
> "In the Sanders case the plaintiffs were stockholders of a mutual fund who brought both class and derivative claims against the Fund's directors and investment advisor. For purposes of the derivative claims only, the Fund itself was joined as a nominal defendant but no class claims were asserted against it. The District Court imposed the costs of extracting the names and addresses of the class members from the Fund's magnetic tapes on the Fund. In reversing, the Court of Appeals

held that it was 'totally improper to impose costs on the Fund' because the Fund was not a party to the class action claims (___F.2d___, at p.___, Slip Op. at p.4583).

"If anything, the facts in the case at bar present an a fortiori situation to the facts in the Sanders case because here the brokerage firms whose customers comprise a part of the class are not as involved as the mutual fund might be said to have been in the Sanders case.

"In addition, as indicated, the facts in the Weiss case appear to be on 'all fours' with those in the case at bar and Judge Stewart was of the opinion that the Court of Appeals decision in Sanders refusing to impose the costs on the mutual fund was determinative of the question present here. We agree." In re Franklin National Bank Securities Litigation, 73 F.R.D. 25, 27 (E.D.N.Y. 1976); (A225-A226)

In light of the fact that Judge Stewart in Weiss v. Drew National Corp., 75 Civ. 4816 (S.D.N.Y., July 19, 1976) (A172-175) relied solely on the panel's decision in Sanders v. Levy in holding that class representatives must pay the costs at issue, it is clear that Judge Platt's decision was wholly determined by his interpretation of Sanders v. Levy.

The decision of the panel in Sanders was predicated upon its view that costs of identifying class members are not properly treated as discovery costs and must automatically be allocated to class representatives. Sanders v. Levy, 21 F.R.Serv. 2d 1213 (2d Cir. 1976). Consequently, Judge Platt deemed his decision to be controlled by a decision requiring automatic imposition of identification costs

on plaintiffs which is no longer the law in this Circuit. Indeed, the specific language quoted by Judge Platt from Judge Palmieri's opinion relates to the question of when, if ever, costs of notice can be shifted to someone other than the plaintiff assuming that, under Eisen IV, the costs involved are to be treated as costs of notice. See 21 F.R.Serv. 2d at 1216. Since this Court has now determined that the costs at issue on this appeal are not costs of notice under Eisen IV, but are rather to be treated as discovery costs, Judge Platt's analysis is based on a view of the law which has proved to be incorrect.

Contrary to the argument in defendants' Supplemental Brief, this Court should not treat the decision below as an exercise of discretion by Judge Platt analogous to that employed by a district judge in allocating discovery costs. In light of his reliance on the decision by the Sanders panel, Judge Platt apparently did not regard himself as having any discretion whatsoever with respect to the allocation of the costs involved. Now that the en banc decision makes clear that a district court does have discretion to allocate costs of identifying class members under the federal discovery rules and to take the relative economic

burden involved into consideration in making such allocation, Judge Platt's consideration of the questions involved and his ultimate decision might be significantly changed.*

(c) Certain of This Court's Conclusions In Sanders Strengthen Appellants' Position that Individual Notice To Record Owners is Sufficient Under Rule 23

Since the names and addresses sought in Sanders were those contained on the list maintained by the Fund's transfer agent, the question whether Rule 23 requires individual notice to class members other than record owners was not presented. However, the en banc opinion in Sanders is wholly consistent with appellants' position that individual notice to record owners is sufficient individual notice under Rule 23, and the Court's analysis lends further

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* Appellees argue that the order below was a proper exercise of Judge Platt's discretion because it allegedly avoided "complex, time-consumming and expensive problems of judicial administration". Appellees' Supplemental Brief, p.9. However, Judge Platt's opinion contains no indication that his decision was determined by an effort to deal with such alleged problems, but only refers to what he deemed to be the controlling force of the original Sanders decision.

support to appellants' position on this point.

The Court's decision that identification costs are discovery rather than notice costs confirms that Eisen IV's statement that notice requirements cannot be "tailored to fit the pocketbooks of particular plaintiffs" (417 U.S. at 176) is irrelevant to the issues herein. Consequently, the economic burden involved is a major consideration in determining whether or not the "reasonable effort" requirement of Rule 23 is consistent with plaintiffs' having to bear the expense of such an effort. The Sanders en banc opinion put special emphasis on the relative ability of the Fund to sustain the expenses involved (Slip Opinion, p.4377).

Appellees' Supplemental Brief itself provides further support for the conclusion that identification of beneficial owners of street name securities would involve an unreasonable effort by plaintiffs. Appellees emphasize the extensive number of nominees ("approximately 661") and stress the burdensome nature of the search required of the nominees. Appellees' Supplemental Brief, pp.8-9.

(d) Even if Individual Notice to Record Owners Alone is Insufficient Under Rule 23, Sanders Supports the Conclusion That the Costs of Identifying Beneficial Owners Should Not Be Allocated to Appellants

In the event that the Court determines that individual notice to record owners alone would be insufficient, the Sanders opinion strongly supports the conclusion that the costs at issue are not properly allocable to class representatives. Under that opinion, such costs should be allocated in accordance with the principles determining allocation of costs of discovery. As shown in the Reply Brief for Plaintiffs-Appellants, pages 10-16, the person responding to a discovery request normally absorbs the costs involved unless it would be unfair or oppressive not to shift the costs to the requesting party. This Court emphasized such a rule in Sanders with respect to discovery of computerized information, stating:

> "The existence of discretion pursuant to Rule 26(c) to reallocate the costs of discovery of computerized information in order to avoid abuse merely underlines the general rule: 'The responding party who is required to prepare a printout or otherwise make the data reasonably useable for the discovering party must ordinarily bear the expense of doing this.'" Slip Op. p.4376.

The rule that the producing person must normally bear his own expense is applicable regardless of whether or not computer operations are involved and whether or not the request is made of a party or of a third party by subpoena. E.g., United States v. Int'l Business Machines Corp., 62 F.R.D. 507, 510, 511 (S.D.N.Y. 1974); Blank v. Talley Industries, Inc., 54 F.R.D. 627 (S.D.N.Y. 1972); 5A Moore, Federal Practice, ¶45.05[2], pp.45-50, fn.45 (2d ed. 1975). Even under Rule 33(c) where parties are permitted to avoid burdensome compilations by producing documents in lieu of such compiliations, the courts have required responding parties to perform the compiliations themselves, at their own expense, if the requesting party is unfamiliar with the type of records involved, or if the records themselves include a large amount of material, and the requesting party cannot efficiently and effectively perform the work involved. See cases cited on pages 13-14 of the Reply Brief of Plaintiffs-Appellants.

In evaluating the propriety of the District Court's refusal to shift the burden of preparing computerized information to plaintiffs, this Court in Sanders stressed the extensiveness of the resources of the responding party and

the fact that the retrieval of such information was consistent with the normal business activity of such company:

> "Although compliance with the district court's order entails an expenditure by the fund in excess of $16,000, we cannot say the burden thus imposed is unreasonable in light of the nature of the information sought and the extent and character of the fund's business operations. Although an expense of $16,000 seems large in absolute terms, the cost of identifying the name and address of each present or former shareholder who is a member of the class is only thirteen cents. Considering the extent of the fund's business, therefore, the burden of compliance with the Rule 34 discovery demand is not excessive. There is no injustice in requiring one whose business is vast and complex to go to proportionately greater lengths to meet the law's legitimate requirements for disclosure of business-related information than might be expected of one whose business is small and simple. Great corporations, for example, must expend millions to provide to the government information necessary to comply with internal revenue laws; an individual taxpayer may provide the required information at a cost to himself of a mere few dollars. It is scarcely unreasonable, moreover, to demand of a respondent that he employ his computer resources to provide discoverable information of a relatively simple nature where, as here, the respondent makes extensive use of computers in the operation of its business." Slip Op. p.4377.

Under such analysis, it would be inappropriate for a district court to rule that plaintiffs in the present action must bear the costs of identifying beneficial owners of street name securities. As shown in appellants' prior briefs, appellants should not bear such costs because of considerations including (a) the relative burden of such

costs to class representatives as opposed to each individual nominee; (b) the extent to which computerized data is required; (c) the unfairness of shifting such costs to plaintiffs in light of the benefits to nominees from utilization of the street name system; and (d) the nominee's own duty under principles of agency law to retransmit the class notice to the beneficial owner.*

Certainly this Court has no basis under Sanders to determine that the costs involved should be shifted to plaintiffs. Existing authority which was not the product of the prior decision in Sanders holds that class representatives should not bear such expenses in analogous situations. E.g., Blank v. Talley Industries, Inc., supra.

CONCLUSION

For the reasons stated above and in plaintiffs' prior briefs, the Court should reverse the orders of October

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* As noted by counsel for appellants during the oral argument of this appeal, appellants' position does not require this Court or the District Court to impose the costs at issue on nominees who are not participating in this litigation, but only to refrain from imposing such costs on appellants. However, it would seem appropriate for the class notice to contain a provision alerting the nominee to the fact that he might be under a duty to transmit the notice to the beneficial owner.

27, 1976 and November 30, 1976 insofar as those orders require plaintiffs to reimburse nominees for their expenses of identifying beneficial owners of nominee name securities.

Dated: New York, New York
August 5, 1977

Respectfully submitted,

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: ss.:
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BLANCHE M. FLOWERS, being duly sworn, deposes and says that she is in the employ of Milberg Weiss Bershad & Specthrie, attorneys for the within Plaintiffs-Appellants herein, and is over the age of twenty one years. That on the 8th day of August, 1977, she served two copies of the within Supplemental Brief of Appellants upon the attorneys for the respective parties named below, by depositing two true copies of the same to each of them, securely enclosed in postpaid wrappers in a post office box regularly maintained by the United States Government at One Pennsylvania Plaza, New York, New York, directed to each of them at their respective addressed set forth below, those being the addresses within the state designated by them for that purpose on the preceding papers in this action, or the places where they then kept their respective offices between which places there then was and now is a regular communication by mail:

SEE ATTACHED LIST

Blanche M. Flowers
BLANCHE M. FLOWERS

Sworn to before me this
8th day of August, 1977.

Judith Goodhart
Notary Public

JUDITH GOODHART
Notary Public, State of New York
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